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GOVERNMENT
CONTRACTORS

Contracting Out Implications
of Streamlining Agency
Operations

Statement of Nye Stevens
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General Government Division



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CONTRACTING OUT IMPLICATIONS
OF STREAMLINING AGENCY OPERATIONS

Summary of Statement by L. Nye Stevens,
Director of Planning and Reporting
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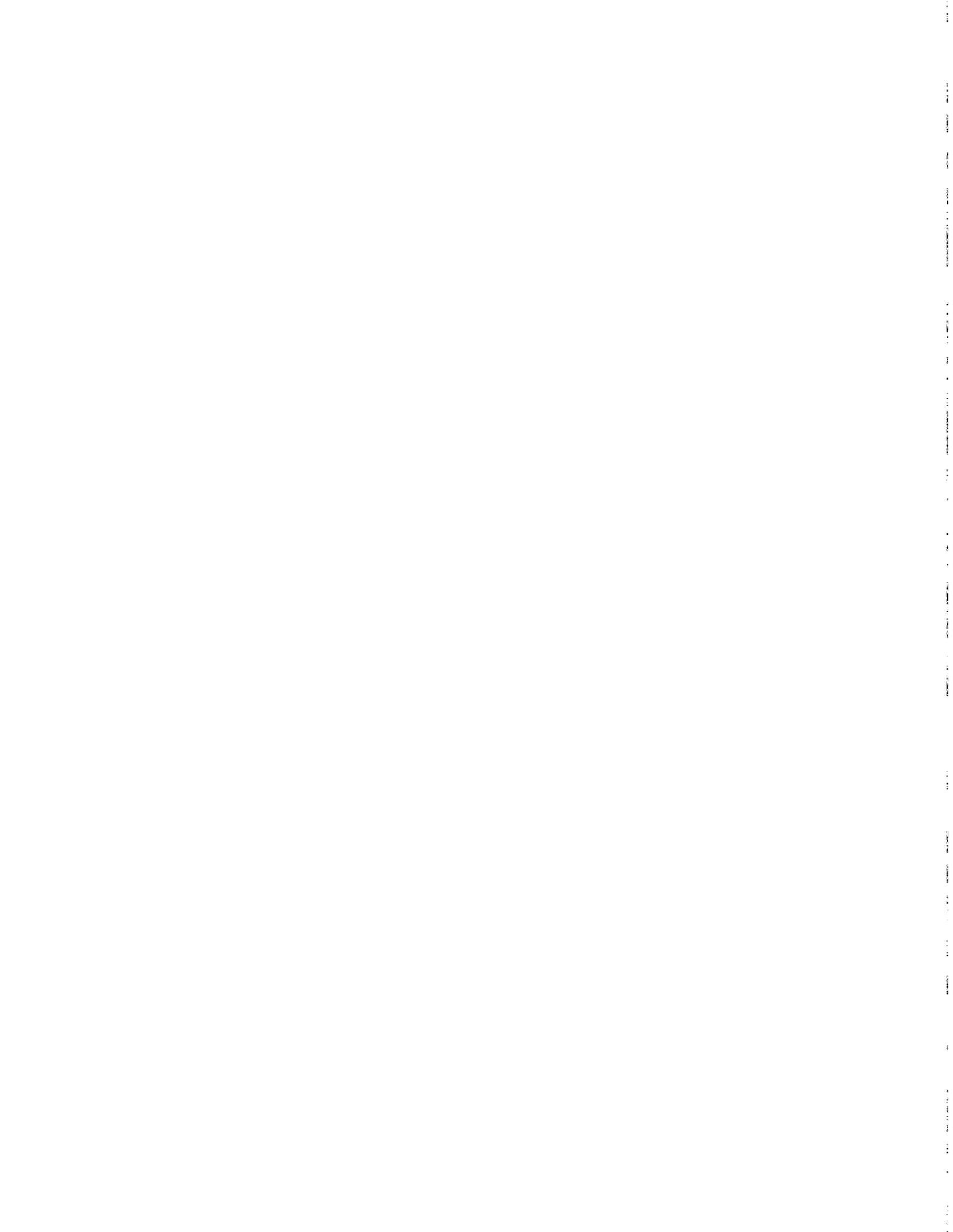
As Congress considers the proposals of the National Performance Review, which advocated downsizing the federal government by approximately 272,900 positions, GAO believes Congress should also consider the possibility that agencies may increase contracting out for services that include professional, administrative, analytical, and management support services.

GAO believes that contractors can provide valuable services to the government. However, GAO believes that before an agency decides whether to contract out for a particular service, the agency should be aware of the comparative cost of contracting out versus using federal employees. Other factors, such as the nature and length of the work and the quality and timeliness of the services, should also be considered.

Until recently, the Office of Management and Budget (OMB) had not specifically instructed federal agencies that cost comparisons are required for advisory and assistance services. Such comparisons were required, however, for commercial activities. In August 1994, OMB instructed agencies to conduct cost comparisons before converting the work of employees included in the 272,900 workforce reduction to contract performance. The cost comparisons must demonstrate that contracting would be to the financial advantage of the government before the work could be contracted. This requirement includes advisory and assistance services affected by agency downsizing.

Studies made by several agency Inspectors General and by GAO have shown that cost comparisons can be useful management tools to decide how to accomplish the government's work in the most cost-effective manner. OMB is considering revising its guidance to agencies for conducting cost comparisons. GAO believes that any revised guidance should also require agencies to consider noncost factors as part of such comparisons.

GAO believes that agencies should have the flexibility to accomplish their work in the best possible manner and should not be constrained by arbitrary personnel ceilings, which could be counter productive and inefficient in certain circumstances. Agencies should determine if contracting out for services or using government employees is more advantageous. To make the best decision for the government, agencies need information that permits managers to make meaningful decisions. Cost comparisons and consideration of noncost factors can provide such needed information.



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here this morning to assist the Subcommittee in its evaluation of the interrelationship of contracting out and the goal of streamlining agency operations. To help ensure that the government works better and costs less, the Vice President's National Performance Review (NPR) has proposed greater competition in the provision of public services. The administration has also set an objective of downsizing the federal workforce by approximately 272,900 positions.¹ One possible effect of this objective could be an increase in the use of contractors to provide various services to the government. The issue that arises is how should agencies go about making this decision to ensure that the public receives the best possible service at the most reasonable cost.

DECIDING WHETHER
TO CONTRACT OUT

The federal government spent almost \$13 billion in fiscal year 1993 for advisory and assistance service contracts. These contracts included professional, administrative, and management support services and special studies and analyses. The contractors who provide these services can play valuable roles in government by supplying expertise that agencies may not have in-house or may not need on a permanent basis. In addition, these contractors can help agencies obtain up-to-date expertise in rapidly changing fields and explore a wide range of knowledgeable viewpoints on controversial issues. However, before federal agencies decide to contract out for such services, we believe that it would be prudent for the agencies to consider the cost of contracting out for these services versus the cost of having the services performed by federal employees. In addition, agencies should also consider other factors in deciding whether to contract out, such as the length and nature of the work in question and the quality and timeliness of the services needed. Consideration of cost differences and noncost factors will help agencies choose the most cost-effective way of getting the work done.

UNTIL RECENTLY, COST COMPARISONS WERE NOT
REQUIRED FOR ADVISORY AND ASSISTANCE
SERVICES

Federal policy regarding the performance of commercial activities was established by "OMB Circular A-76." This circular requires that cost comparisons be made to determine whether agencies should use contractors or government employees to perform commercial activities such as automatic data processing, guard

¹From Red Tape to Results: Creating a Government that Works Better and Costs Less, Vice President Al Gore, Sept. 7, 1993.

and protection services, and maintenance and repair services. An A-76 cost study involves comparing estimated contract and in-house costs for the specific work to be performed to determine the most cost-effective approach. The circular does not, however, state that cost comparisons must be made for advisory and assistance services.

OMB's Cost Comparison Handbook, a supplement to the circular, furnishes the guidance for computing cost comparison amounts. Agencies considering contracting are to prepare a document containing the government's estimate of the lowest number and type of employees required to do the work described. From these data and other estimated costs, the agency is to prepare a total estimated cost for in-house performance. To estimate contractor performance costs, the selected bid or offer is added to other estimated costs, such as contract administration, to develop a total projected cost for contracting out. The circular requires the agency to compare the two estimates to determine which alternative is more cost-effective.

In contrast to the A-76 requirements covering commercial activities, agencies were not required, until recently, to conduct cost comparisons in determining whether to contract for advisory and assistance services. Accordingly, it is not generally known whether it costs less to contract out for these services or use government employees to perform the work. However, certain individual studies have been made by us, agency Inspectors General, and others to measure comparative costs of obtaining advisory and assistance services.

In March 1994, we issued a report to the Chairman, Subcommittee on Federal Services, Post Office and Civil Service, Senate Committee on Governmental Affairs on the methodologies and results of nine studies.² In that report, we said although the nine studies indicated that savings might be available in certain situations if services were performed by federal employees rather than by contractors, all of the studies had limitations. For example, none were sufficiently large or comprehensive to permit generalization to other situations in the government as a whole, or even within the agencies in question.

The studies also varied in the extent to which they incorporated all possible cost factors. Because "OMB Circular A-76" contains an extensive list of items to consider--most of which, we believe, would be equally applicable to advisory and assistance services--we believe it could serve as a useful source of criteria for studies such as these. One study of seven headquarters' administrative, management, and technical support contracts used substantially all of the extensive cost elements

²Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95, Mar. 10, 1994).

contained in "OMB Circular A-76." Four additional studies used some, but not all, of these cost elements. The remaining four studies limited their methodologies to determining or estimating direct labor costs and comparing them to contract labor costs.

We believe, however, that these types of studies, if properly done, provide agency managers with important tools to help them decide whether to contract out or use government employees. These studies should also consider relevant noncost factors. Generally, decisions should not be made without sufficient information because the more information available, the better informed and appropriate the decisions may be.

In addition to cost, we believe agencies would need to consider other factors, such as quality and timeliness, in deciding whether to contract out for advisory and assistance services. For example, if the advisory and assistance services sought were short term and nonrecurring in nature, it might be practicable for an agency to contract out even if it costs less in the short term to hire staff to do the work in-house. An agency should also consider the quality and timeliness of the services required and determine whether available federal employees have the necessary technical skills or knowledge needed to perform the task.

In commenting on a draft of our March 1994 report, OMB officials noted that it may not be necessary or practicable to require cost comparisons for all types of advisory and assistance services. In particular, they suggested that in certain circumstances, such as those involving activities where the work requirements are short term and nonrecurring, cost comparisons would not be necessary. They suggested that these and other noncost factors be considered before making a decision to conduct a cost comparison.

We agree that it would be reasonable to first require consideration of noncost factors before making a cost comparison for advisory and assistance services. We believe, however, that OMB should require agencies to adequately justify and document decisions not to conduct cost comparisons and not allow agencies to use these factors solely as a basis for avoiding the comparisons.

In response to our March 1994 report, OMB advised us in May 1994 that it was considering a number of revisions to its A-76 guidance. OMB said it may be appropriate, under certain circumstances, to apply the cost comparison requirements of Circular A-76 to advisory and assistance services. An OMB official also expressed his belief that when Circular A-120, Guidelines for the Use of Advisory and Assistance Services, was rescinded in November 1993, the distinction between advisory and assistance services and other services was, in effect, removed. The official said that consequently, the cost comparison

requirements of A-76 would apply. He agreed, however, that this distinction might not be clear to agencies.

In addition to OMB's planned efforts to consider revising Circular A-76, we should also note that the Federal Workforce Restructuring Act of 1994 (P.L. 103-226, section 5(g)) takes a step toward requiring such comparisons. This law provides that there should be no increase in the procurement of any services by reason of the federal downsizing effort, except in cases in which a cost comparison demonstrates such contracts would be to the financial advantage of the federal government. The law, however, also established ceilings on the total number of full-time equivalent positions for federal agencies, which could affect the ability of federal agencies to accomplish their mission. We noted that in August 1994, OMB advised all federal agencies that an A-76 cost comparison should be made before any work is converted from in-house to contract performance as a result of the Federal Workforce Restructuring Act's downsizing. This requirement includes advisory and assistance services.

We are pleased that the August 1994 OMB instruction extends the cost comparison requirement to those advisory and assistance services affected by the Federal Workforce Restructuring Act. We do not believe, however, that the rescission of Circular A-120 clearly conveyed a requirement to conduct cost comparisons for advisory and assistance services to federal agencies. If this is indeed OMB's intention, we believe that this should be clearly and specifically communicated to all agency heads so that they may be aware of and implement any new requirement to make such cost comparisons. OMB should consider making this clarification part of its overall revision of Circular A-76.

AGENCIES NEED FLEXIBILITY TO
ACCOMPLISH THEIR WORK IN THE
MOST COST-EFFECTIVE MANNER

Once agencies consider the comparative costs of contracting out versus using in-house personnel and the relevant noncost factors, we believe that agencies then need to have the flexibility to have the work performed in the most cost-effective manner. If agencies determine that it is advantageous to contract out, then they should do so. However, if they determine that using government employees to perform the work is more advantageous, they should have the ability to do so and not be constrained by ceilings on the number of positions they may be granted to accomplish their work.

The NPR has advocated

- requiring individual agencies to compete with other agencies and private companies to provide support services,

- providing agencies with flexibility to obtain services from the best possible source, and
- eliminating personnel ceilings and allowing federal managers to manage to budget using ceilings on operating costs to control spending. The report recognized that personnel ceilings could cause agencies to contract out work that could be done more efficiently and less costly in-house.

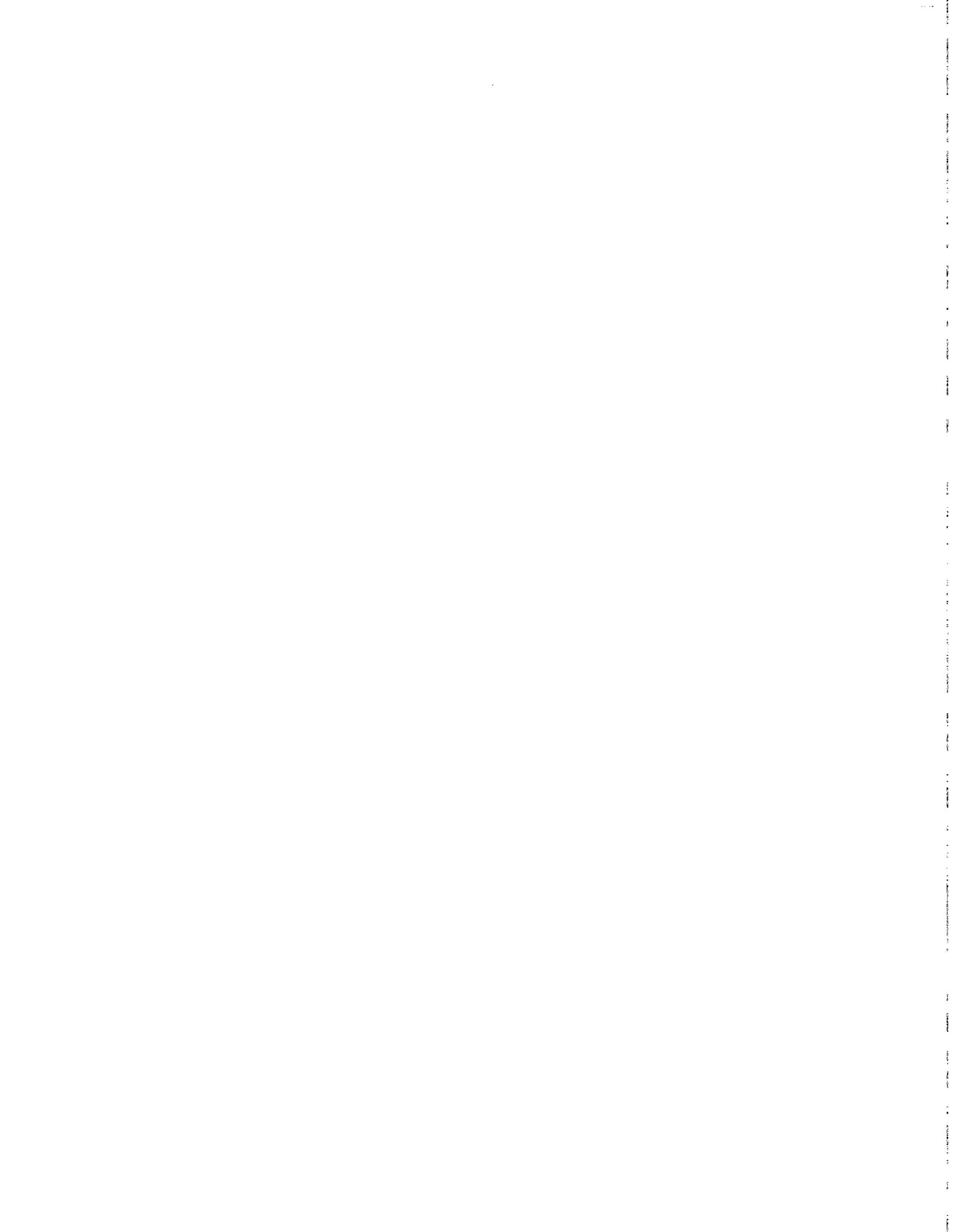
The NPR findings corresponded with our previous observations that federal managers should have the authority and flexibility to obtain services for the government in the most cost-effective manner. For example, in one of our Transition Series Reports,³ we noted that federal managers have often not had sufficient flexibility to choose between hiring employees or contractors because of restrictive personnel ceilings imposed by either OMB or Congress. As a result, agencies frequently used contractors even when they believed it might be more appropriate to use federal employees because of the nature of the work involved or because it would be less costly.

Providing agencies with the needed flexibility to choose between using employees and contractors, however, creates a potential dilemma because of the administration's overall goal of downsizing the federal workforce by approximately 272,900 positions and the requirements of the Federal Workforce Restructuring Act of 1994. As I indicated, the act imposed ceilings on the number of federal employees and also established restrictions on contracting if a cost comparison shows that contracting would not be financially advantageous to the government. These conditions could place federal agencies in a position in which they could not accomplish necessary work either by using federal employees or by contract. The act, however, provides the President with the authority to waive agency personnel ceilings if he determines that the efficiency of the agency or the performance of a critical agency mission requires that a waiver be granted, and provided the governmentwide personnel ceilings in the act are not exceeded. If such waiver authority is exercised, it could alleviate this potential dilemma.

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This concludes my prepared statement. I will be pleased to answer any questions you or the Members of the Subcommittee may have.

³The Public Service (GAO/OCG-93-7TR, Dec. 1992).



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